Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
1997 Annual Access Tariff Filings	)	CC Docket 97-149
	)	

MEMORANDUM OPINION AND ORDER ON RECONSIDERATION

Adopted: March 31, 1998 **Released:** March 31, 1998

By the Commission: Commissioner Furchtgott-Roth issuing a separate statement.

I. Introduction

1. The Bell Atlantic Telephone Companies (Bell Atlantic) and SBC Communications, Inc. (SBC) have filed petitions for reconsideration of our order concluding our investigation of local exchange carrier (LEC) 1997 annual access tariff filings.[1] The Puerto Rico Telephone Company (PRTC) filed a petition for clarification of the *1997 Annual Access Tariff Investigation Order*. In this Memorandum Opinion and Order, we deny the petitions for reconsideration filed by Bell Atlantic and SBC Communications, and grant the petition filed by PRTC.

II. Common Line Issues

2. Bell Atlantic seeks reconsideration of the finding in the *1997 Annual Access Tariff Investigation Order* that it and other price cap LECs have understated their per-line base factor portion (BFP) revenue requirement forecasts in a statistically significant manner since 1991. Bell Atlantic also seeks reconsideration of our decision to require refunds of excess carrier common line (CCL) revenues collected between July 1 and December 31, 1997.

A. Background[2]

1. Application of the Price Cap Rules

3. In preparing its annual access tariff filing, each incumbent LEC must forecast its common line costs and end user demand levels for the upcoming tariff year. These forecasts,

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[1] *1997 Annual Access Tariff Filings*, Memorandum Opinion and Order, 13 FCC Rcd 3815 (1997) (*1997 Annual Access Tariff Investigation Order*).

[2] For a fuller explanation of the practices and charges at issue, see *1997 Annual Access Tariff Investigation Order*, at ¶¶ 5-102.

in turn, are used to determine the LEC's monthly per-line BFP revenue requirement.[3] The LEC then uses this monthly per-line BFP revenue requirement to set its end user common line (EUCL) charge, subject to certain EUCL caps provided in the Commission's rules.[4] A price cap LEC then sets its presubscribed interexchange carrier charges (PICCs) and its per-minute CCL charges to recover the difference between its anticipated EUCL revenues and the total common line revenues permitted by its price cap.[5]

2. The 1997 Annual Access Tariff Investigation

4. In the 1997 annual access tariff investigation, the Common Carrier Bureau designated for investigation the issue of whether the price cap LECs had justified their BFP revenue requirement and EUCL demand projections.[6] We explained in the *1997 Annual Access Tariff Investigation Order* that a price cap LEC may be able improperly to increase its overall common line revenues by understating its per-line BFP revenue requirement and calculating correspondingly higher CCL rates. We explained that a price cap LEC that has a EUCL charge below the multi-line business (MLB) EUCL cap, and that expects growth in minutes-of-use (g) in the upcoming tariff year to exceed $g/2$ from the previous year, will be able to increase its overall common line revenues by understating its per-line BFP revenue requirement because the revenue from increases in CCL charges will more than offset the revenues foregone from lower EUCL charges. In the investigation, we used a variety of statistical testing techniques, including graphical analysis, a nonparametric sign test, and a "difference in the means" test, to evaluate whether the price cap LECs' per-line BFP revenue requirement forecasts were reasonable. We concluded that several of the price cap LECs had unjustly and unreasonably understated their per-line BFP revenue requirement forecasts for tariff year 1997-98, and had tariffed CCL rates that were correspondingly unjustly and unreasonably high. We therefore prescribed per-line BFP revenue requirement forecasts for these LECs, and ordered refunds to interexchange carriers (IXCs) of the difference between

[3] 47 C.F.R. §§ 69.501, 69.502.

[4] The EUCL charge is also referred to as the subscriber line charge (SLC). For price cap LECs, residential and single-line business EUCL charges are capped at $3.50 per month, while non-primary residential line EUCL charges are currently capped at $5.00 per month. The MLB EUCL charge assessed by price cap LECs currently may not exceed $9.00 per month. 47 C.F.R. § 69.152. A price cap LEC's MLB EUCL charge may exceed its monthly per-line BFP revenue requirement forecast only to the extent necessary to recover certain marketing expenses. 47 C.F.R. § 69.156 (permitting price cap LECs to increase the MLB EUCL charge and non-primary residential EUCL charge above the monthly per-line BFP revenue requirement to recover marketing expenses).

[5] 47 C.F.R. § 61.46(d-e).

[6] *1997 Annual Access Tariff Investigation*, Order Designating Issues for Investigation and Memorandum Opinion and Order on Reconsideration, 12 FCC Rcd 11417, 11424 (Com. Car. Bur. 1997).

the CCL rates actually in effect between July 1, 1997 and December 31, 1997, and CCL rates computed using our per-line BFP revenue requirement prescription.[7]

B. Bell Atlantic's Petition for Reconsideration

1. Procedural and Policy Issues

5. Bell Atlantic argues that the Commission's order requiring refunds violates the Commission's price cap rules because the refund will prevent Bell Atlantic from recovering the full amount of its total common line basket revenues otherwise permitted under the Commission's price cap rules and not otherwise in dispute.

6. Bell Atlantic further maintains that it should not be subjected to any refund liability because it sought, but did not receive, guidance from the Commission in July and August, 1997, as to any adjustments it should make to minimize its refund liability. Bell Atlantic states that this fact distinguishes this case from the *1993-1996 Annual Access Tariff Filings* investigation, where the Common Carrier Bureau found that Bell Atlantic had chosen to disregard prior directives and thereby assumed the risk that refunds would be ordered.[8] As such, Bell Atlantic argues in its petition that refunds are not warranted in this case because the balance of the equities weighs in favor of the LECs.[9] Bell Atlantic contends that the Commission was in error to order "certain LECs to refund common line charges paid by long distance carriers without providing a method to recover that same amount . . . from end users."[10]

7. The CCL refunds ordered in the *1997 Annual Access Tariff Investigation Order* do not violate the Commission's price cap rules. The common line price cap does not represent a revenue entitlement or a revenue guarantee. Instead, it establishes rate levels, at or below which the price cap LEC's rates "will be considered *prima facie* lawful, and will not be

[7] We also concluded that one effect of such forecasts over time is to unreasonably inflate the total common line revenue requirement. While the record in this investigation was insufficient to permit us to take prescriptive action to reduce the common line basket price cap index (PCI), we stated that, "a LEC that has consistently understated its per-line BFP revenue requirement over the course of several years has also consistently and correspondingly inflated its maximum CCL rate." *1997 Annual Access Tariff Investigation Order*, at ¶ 101.

[8] *1993-1996 Annual Access Tariff Filings*, Memorandum Opinion and Order, 12 FCC Rcd 8349, 8355-56 (Com. Car. Bur. 1997).

[9] Bell Atlantic Petition at 5-6.

[10] Bell Atlantic Petition at 4.

suspended by the Commission" unless a petitioning party shows that specific criteria are met.[11] Even under price cap regulation, carriers bear an obligation under the Communications Act to tariff just and reasonable rates.[12] Therefore, Bell Atlantic must develop carrier and end user common line rates that are computed in a just and reasonable manner under our Part 69 access charge rules, and that are based on just and reasonable projections of its per-line BFP revenue requirement. Under price cap regulation, common line rates that mathematically comply with the Part 61 price cap formulae may nevertheless be unjust and unreasonable if they are developed using unreasonable per-line BFP revenue requirement forecasts.[13] Bell Atlantic, and other carriers that used such unreasonable forecasts to develop their common line rates, remain potentially liable for refunds of any overcharges that result, notwithstanding their compliance with the Part 61 formulae.

8. We agree with Bell Atlantic that the effect of our refund order may be to reduce its common line revenues for tariff year 1997-98 below its expectation, and below the level that would have been permitted under our price cap rules, *if* Bell Atlantic had used reasonable per-line BFP revenue requirement forecasts. In developing its rates for tariff year 1997-98, however, Bell Atlantic tariffed EUCL and CCL rates that were based on unjust and unreasonable forecasts of its per-line BFP revenue requirement, as we determined in our previous decision. Therefore, although Bell Atlantic computed its EUCL and CCL rates using the price cap formulae, these rates were based on an unreasonably low BFP revenue requirement forecasts that resulted in unreasonably high CCL rates. In general, a carrier cannot recoup its losses from a rate the Commission ultimately determines has been set unjustly or unreasonably low, or offset such losses against refunds owed for rates that were too high. As the Supreme Court has explained:

> [A] rate for one class . . . of customers may be found by the Commission to be too low, but the company cannot recoup its losses by making retroactive the higher rate subsequently allowed; on the other hand, when another class . . . of customers is found to be subjected to excessive rates and a lower rate is

[11] 47 C.F.R. § 1.773(a)(1)(iv).

[12] 47 U.S.C. §§ 201-205.

[13] The Common Carrier Bureau recently considered a tariff transmittal filed by SBC Communications Inc. proposing that its refund obligation be treated as a "common line basket exogenous cost targeted to the EUCL," and increasing its MLB EUCL temporarily to recover these costs. Letter from David Ho, Director-Access Product Management/Special Access to Magalie Roman Salas, Secretary, Federal Communications Commission, Transmittal No. 2683 ("Transmittal No. 2683"), filed Jan. 16, 1998. The Bureau rejected this filing because it did not comply with the Commission's Part 69 rules for computing the EUCL charge, and because, even ignoring the Part 69 problem, the filing "constitute[d] either a price cap filing not in compliance with sections 61.45(c) and 61.46(d), or an above-cap filing not in compliance with section 61.49(e)." *Southwestern Bell Tel.Co.*, Transmittal No. 2683, 13 FCC Rcd 2437 (Com. Car. Bur. 1998).

> ordered, the company must make refunds to them. The company's losses in the first instance do not justify its illegal gain in the latter . . . . The company having initially filed the rates and either collected an illegal return or failed to collect a sufficient one must, under the theory of the Act, shoulder the hazards incident to its action including not only the refund of any illegal gain but also its losses where its filed rate is found to be inadequate."[14]

Consistent with the Supreme Court's explanation, the Commission does not ordinarily allow carriers, at the end of a tariff investigation conducted under Section 204 of the Communications Act of 1934, as amended,[15] to recoup past undercharges, or to offset revenues foregone from one rate element against refunds owed for overcharges, absent unusual circumstances and prior notice to customers. We find that this policy is particularly applicable here because, in this case, a different class of customers received the benefits of the low rate from the one that was subjected to the unlawfully high rate.

9. We conclude that a balancing of the equities in this case continues to support our earlier order that requires Bell Atlantic to issue refunds to IXCs for CCL overcharges. The Communications Act places with the Commission a statutory obligation to ensure that rates are just, reasonable and nondiscriminatory.[16] Consistent with the Supreme Court's reasoning in *FPC v. Tennessee Gas*, the Commission has not generally permitted carriers to retain earnings from rates that were set too high, thereby increasing carrier incentives to set just and reasonable rates initially. Bell Atlantic has offered us no convincing reason to depart from this policy in this case. Certain of the price cap LECs charged IXCs unreasonably high CCL rates for the time period from July 1, 1997, through December 31, 1997. With the advent of competition, excessive CCL charges not only contribute to inflated toll calling rates, artificially depressing demand for these services, but also represent a transfer of revenues to the LECs from their potential competitors, the IXCs. Similarly, by artificially decreasing EUCL charges, these LECs have made it more difficult for potential new local market entrants to offer competitively priced local service. Under such circumstances, we conclude Bell Atlantic should not be permitted to retain excess CCL revenues that are the result of its own biased per-line BFP revenue requirement forecasts. Instead, we conclude that refunds are necessary to protect end-users' and IXCs' interests in the development of competition and in obtaining just and reasonable toll calling rates.

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[14] *FPC v. Tennessee Gas Trans. Co.*, 371 U.S. 145, 152-53 (1962).

[15] 47 U.S.C. § 204.

[16] 47 U.S.C. §§ 201-205.

10. Furthermore, and contrary to Bell Atlantic's assertion, the Common Carrier Bureau provided Bell Atlantic with adequate notice of its potential refund liability in this investigation. Specifically, the Common Carrier Bureau (1) suspended the Bell Atlantic access tariff revisions; (2) ordered Bell Atlantic to keep an accurate account of all amounts received in the event that refunds become necessary; and (3) designated for investigation the issue of whether Bell Atlantic and the other price cap LECs had justified their BFP revenue requirement and EUCL demand projections, in response to IXC allegations that systematic understatement of the BFP revenue requirement had improperly inflated CCL charges.[17] In addition, the Common Carrier Bureau issued its suspension order in response to petitions filed by AT&T and MCI that specifically challenged Bell Atlantic's common line rates as unjust and unreasonable. Bell Atlantic's assertion that it unsuccessfully sought guidance during the pendency of this investigation from Commission staff regarding its BFP revenue requirement forecasts does not change our conclusion that refunds are necessary in this case. Bell Atlantic had notice that its BFP revenue requirement forecasts were a major issue in this investigation and it was free at any time to revise its access tariff to minimize its potential EUCL revenue losses. Neither Bell Atlantic nor any other carrier is entitled to know the results of a Commission tariff investigation before the Commission itself has decided the issues. A carrier's obligation to tariff just and reasonable rates and its potential liability for refunds when it fails to do so are not contingent on the receipt of guidance from Commission staff during the course of a tariff investigation.

2. Validity of the Commission's Statistical Testing Methods

11. In analyzing the price cap LECs' per-line BFP revenue requirement forecasts, we used a three-step analysis, consisting of graphical analysis, nonparametric sign testing, and a difference in the means test. This analysis led us to conclude that several of the price cap LECs had understated their per-line BFP revenue requirement in a statistically significant manner since 1991.

12. In its Petition, Bell Atlantic argues that our statistical analysis of its BFP forecasting since 1991 is flawed. Bell Atlantic argues that we should have applied a 95 percent, instead of a 90 percent, confidence interval to the results of both the sign test and the difference in the means test. In addition, Bell Atlantic argues that the autoregressive forecasting technique we used provides projections that are less accurate than Bell Atlantic's own forecasts for two of the past three tariff years, and that we should have projected the

[17] *Southwestern Bell Tel. Co. v. FCC*, No. 97-3446, ___ F.3d ___, 1998 WL 102481 (8th Cir. Mar. 11, 1998), at *4 ("[A] possible secondary purpose of the suspension, that is, to put the company with the proposed rates on notice of possible defects in the tariff, is served by another provision in the section, namely, that the FCC may require the proposing companies to keep an accounting during the period of investigation in order to facilitate a refund should one be necessary").

BFP revenue requirement separately and applied the result to Bell Atlantic's line count forecasts. We disagree with all of these arguments.

13. As we discussed in the *1997 Annual Access Tariff Investigation Order*, the choice of a reasonable confidence interval can be a difficult judgment.[18] In choosing the 90 percent confidence interval in this case, however, we continue to believe that we struck an appropriate balance between the interests of IXCs and LECs. In this investigation, we sought a confidence interval that permitted LECs a reasonable margin for error, but that was likely to capture genuine downward bias in a LEC's forecasts. We therefore stated that, "[i]n our judgment, a 90 percent confidence interval reasonably assures that, if a LEC fails this test, the failing result will not be due to chance."[19] We also disagree with Bell Atlantic that the small sample size present here makes the use of a 95 percent or 99 percent confidence interval more appropriate. The *t* statistic we used in the difference in the means test is calculated to account for the lower degree of confidence associated with small sample sizes, and in fact varies with the size of the sample.[20]

14. Moreover, the record, as supplemented on reconsideration, continues to support our selection of the 90 percent confidence interval. Bell Atlantic, in its petition, quotes a 1965 statistical text for the proposition that only a small group of statistical researchers routinely uses a 90 percent confidence interval.[21] MCI, however, cites other, more recent statistical texts that characterize confidence intervals of 90 percent, 95 percent, or 99 percent as "usual" or "typical."[22] In selecting a confidence interval in this instance, the Commission must balance the risks to IXCs and ratepayers arising from the potential failure to detect genuine downward bias against the dangers to LECs arising from the treatment of chance variations as statistically significant. The competing views reflected in the record reinforce our conclusion that the choice of an appropriate confidence interval is one that must be made

[18] *1997 Annual Access Tariff Investigation Order*, at ¶ 47.

[19] *Id.*

[20] The *t* distribution approximates a normal, bell-shaped curve, modified to accommodate small sample sizes. The critical *t* indicates a statistically significant difference in the mean forecast and mean actual per-line BFP revenue requirement at a given level of significance. Because we received incomplete data from some companies, the critical *t* differs in this investigation for Frontier (sample size=4), GTE (sample size=5), and the other LECs (sample size=6). This difference indicates that the critical *t*, no matter what the sample size, represents the level at which we can state, to the .10 level of significance, that a particular LEC's forecasting errors are statistically significant.

[21] Bell Atlantic Petition at 10 n.22.

[22] MCI Opposition at 11 n.32.

as a matter of judgment, and that the 90 percent confidence interval chosen here is both accepted in the field of statistics and appropriate to this investigation.

15. Similarly, we reject Bell Atlantic's argument that we should have applied a 95 percent confidence interval to the results of our sign test. The 95 percent confidence interval would permit us to reject the null hypothesis only when the LEC understated its per-line BFP forecast in every one of the past six years. We are not prepared to adopt such a stringent criterion. As discussed above, such small confidence intervals, in our judgment, are inadequate in this case to protect IXC and end user ratepayers' interests.

16. We also disagree with Bell Atlantic's assertion that we should have evaluated potential bias in the per-line BFP forecasts using a "two-tailed" test, *i.e.*, that we should have tested for both downward and upward bias in the per-line BFP revenue requirement forecasts.[23] We set up our investigation, including our statistical analysis, to test whether any of the price cap LECs had understated their per-line BFP revenue requirement forecasts. While we agree with Bell Atlantic that there are also potential dangers associated with overstatement of the per-line BFP revenue requirement, at no time in this investigation did we receive serious allegations that any statistically significant overstatement had occurred. To the contrary, several factors suggested that our investigation should focus only on potential understatement of the per-line BFP revenue requirement. AT&T and MCI originally petitioned the Commission to investigate allegations that the price cap LECs had unjustly and unreasonably understated their BFP revenue requirement forecasts. In addition, our own analysis of our rules indicated that the price cap LECs may face an incentive to understate their per-line BFP revenue requirement. Finally, our initial graphical analysis indicated that the vast majority of forecasting errors represented underestimates of the per-line BFP revenue requirement. Given these circumstances, we determined to test for statistically significant downward bias only.

17. Furthermore, while the *Designation Order*[24] sought information relating to errors in both directions, and required the price cap LECs to explain patterns of over- or under-estimation,[25] no LEC provided any information indicating that it experienced a pattern of overestimation, and few LECs provided significant information explaining the source of any

[23] A two-tailed test evaluates whether the difference in the mean actual and mean forecasted per-line BFP revenue requirement falls too far to either extreme end of the t distribution. The one-tailed test that the Commission used to evaluate the LEC forecasts tests only whether the difference in the means falls too far to one extreme, *e.g.*, the left-hand end of the distribution only.

[24] *1997 Annual Access Tariff Filings*, Memorandum Opinion and Order, 12 FCC Rcd 11417 (Com. Car. Bur. 1997) (*Designation Order*).

[25] *Designation Order*, 12 FCC Rcd at 11425.

overestimates they had experienced. In addition, our initial graphical analysis indicated that 58 of the 75 total observations, including 34 of the BOCs' collective 42 observations, took the form of underestimates. Therefore, given the petitioners' allegations under investigation, our own analysis of likely LEC incentives, and the appearance of the data set as a whole, we properly formulated our null hypothesis to test for a downward bias only. Thus, our use of a one–tailed test does not constitute grounds for granting reconsideration.

18. Bell Atlantic also challenges our conclusion that the price cap LECs have an incentive to understate their per-line BFP revenue requirement. While Bell Atlantic apparently agrees that the allocation of common line costs between rate elements is not a "zero-sum" game if *g* exceeds the previous *g*/2, it asserts that the LECs cannot assume that *g* will always exceed *g*/2 from the previous period.[26] Bell Atlantic's own data from the NYNEX companies show, however, that *g* most often substantially exceeds the previous *g*/2, and seldom if ever falls below the previous *g*/2 by a significant amount.[27] Thus, we reject Bell Atlantic's assertion that LECs cannot assume that *g* will exceed the previous *g*/2 in many instances. Bell Atlantic asserts that, in any event, the NYNEX companies' MLB EUCL has been above the EUCL cap for the past two years, removing any incentive it might otherwise have had to understate its per-line BFP revenue requirement. While this fact has limited NYNEX's ability to profit from understating its per-line BFP revenue requirement, it cannot provide assurance that the NYNEX companies' forecasting techniques are unbiased.[28] In addition, on July 1, 1997, the MLB EUCL cap increased to $9.00 monthly. Like many of the price cap LECs, the NYNEX companies' MLB EUCL does not exceed this increased cap, making accurate and unbiased forecasts even more important.

[26] Bell Atlantic Petition at 7. In addition, while characterizing the amount to be gained as "trivial," U S WEST concedes in its comments that a price cap LEC can increase its overall common line revenues by understating its per-line BFP revenue requirement. U S WEST Comments at 5-6.

[27] In its petition, Bell Atlantic provides the following values of *g*:

1991	6.4% (New England); 5.5% (New York)
1992	3.2%
1993	4.5%
1994	2.2%
1995	3.8%
1996	3.6%
1997	1.7%

Bell Atlantic Petition at Exhibit 1.

[28] We have previously rejected this argument, as it applied to Sprint. *1997 Annual Access Tariff Investigation Order*, at ¶ 71.

3. Use of Autoregressive Forecasting Techniques

19. Bell Atlantic argues that, in prescribing per-line BFP revenue requirement forecasts and ordering refunds using autoregressive forecasting techniques, the Commission violated its due process rights. Specifically, Bell Atlantic argues that the Commission improperly ordered refunds based on an allegedly "new method of allocating common line costs" between IXCs and end users.[29] The Commission announced this new method, according to Bell Atlantic, after the fact and without affording Bell Atlantic an opportunity to cure the defects in its ratemaking process, effectively penalizing Bell Atlantic's failure "to guess with absolute precision what the Commission would require."[30] Contrary to Bell Atlantic's assertions, however, the *1997 Annual Access Tariff Investigation Order* adopted no new requirements with respect to the allocation of common line costs. Rather, having used statistical analysis to determine that certain price cap carriers had unreasonably understated their per-line BFP revenue requirement forecasts, we used autoregressive techniques to prescribe per-line BFP revenue requirement forecasts that are in accord with actual historical levels.[31] While this investigation represents the first time we have prescribed per-line BFP revenue requirement forecasts, we are fully authorized to make such prescriptions in setting just and reasonable rates in a tariff investigation conducted pursuant to sections 201-205 of the Communications Act.[32]

20. Moreover, we have not mandated LEC use of autoregressive forecasting techniques, or of any other specific forecasting method, in developing future forecasts. The Commission's rules continue to permit the price cap LECs to use any reasonable forecasting method. As we stated in our previous order: "We continue to believe that there are many different methods that could produce reasonable forecasts for individual LECs, and that it would be counterproductive for us to prescribe the use of any particular methodology."[33]

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[29] Bell Atlantic Petition at 4.

[30] *Id.* at 4-5.

[31] In performing this analysis, we specifically requested in the *Designation Order* that each LEC provide information as to whether its forecasts were consistent with the levels suggested by historical patterns and, if not, the reasons for the deviation. *Designation Order*, 12 FCC Rcd at 11429, 11431-32. Bell Atlantic, in its Direct Case, argued that both its BFP revenue requirement forecast and it line count projections for the NYNEX companies were consistent with the historical trend — an argument we later rejected — but provided no information that would lead us to conclude that the historical pattern was changing or otherwise unreliable. Bell Atlantic Direct Case, at 17-18, 25.

[32] 47 U.S.C. §§ 201-205.

[33] *1997 Annual Access Tariff Investigation Order*, at ¶ 76.

21. We emphasize that our use of autoregressive forecasting techniques was fully justified. We stated that "prescribing a reasonable forecast based on six data points is, at best, a difficult task that is made more difficult by our lack of access to data regarding future LEC business and construction plans."[34] To complete this task, we examined the results provided by several forecasting techniques, including a simple arithmetic average, a trend-based forecasting technique, geometric and moving averages, and autoregression. We chose to base our prescriptions on the results of the autoregression for several reasons. First, while some of the LECs' actual per-line BFP revenue requirements appeared to show a strong trend over time, others did not. Autoregression can detect and respond to patterns in the data, while approximating a simple average when no pattern is present.[35] As we discussed in the *1997 Annual Access Tariff Investigation Order*, "[a] major advantage of this method is that if there is a significant trend in the data, this method will base the forecast on that trend. If there is no trend, the forecast will approximate the arithmetic mean of the data. This is the most reasonable forecasting methodology we can employ with the data available."[36] Second, our examination of the results of other forecasting techniques confirmed our conclusion that autoregression provided reasonable results. For three of the four companies to which we applied this technique, autoregression produced forecasts that were lower than the trend-based forecast, but higher than the arithmetic mean. The fourth, U S WEST, provided per-line BFP revenue requirement data that show a strong, statistically significant trend over time. For U S WEST, the autoregressive forecast approximated the results of our trend-based technique.[37]

22. We did not conclude in the 1997 annual access tariff investigation that autoregressive techniques would provide the most accurate results possible. Rather, our limited knowledge of detailed LEC business plans made forecasting based on more individualized circumstances impossible. Because a price cap LEC's knowledge of its own individual circumstances is likely to be far superior to ours, we expect that individual LECs will be capable of improving significantly on our autoregressive forecasts. As we noted in the *1997 Annual Access Tariff Investigation Order*, however, the failure of these LECs actually to develop just and reasonable per-line BFP revenue requirement forecasts at the outset necessitated our prescriptive action.

23. We are not persuaded to grant reconsideration by Bell Atlantic's assertion that our autoregressive forecasting technique is less accurate than Bell Atlantic's own forecasts. Bell

[34] *1997 Annual Access Tariff Investigation Order*, at ¶ 81.

[35] *1997 Annual Access Tariff Investigation Order*, at ¶ 78.

[36] *1997 Annual Access Tariff Investigation Order*, at Appendix B, p. B-7.

[37] *Id.*, at ¶ 83.

Atlantic provides data showing that its own forecasts were more accurate than those using autoregression in two of the past three tariff years. This result is neither surprising nor significant. Moving backward in time, we would expect to see increasingly poor results using autoregression. Neither we nor Bell Atlantic used pre-1991 rate-of-return data in developing autoregressive per-line BFP revenue requirement forecasts. Therefore, while we were able to take advantage of six data points in developing autoregressive forecasts for tariff year 1997/98, Bell Atlantic's autoregressive forecast for tariff year 1994/95, for example, can take advantage only of three data points. Indeed, Bell Atlantic's autoregressive forecasts for tariff years 1995/96 and 1996/97 are both considerably more accurate than those for tariff year 1994/95.[38]

4. Nor do we agree with Bell Atlantic that we should have projected the BFP revenue requirement separately, and applied this projection to Bell Atlantic's own line count forecasts. As we explained in the *1997 Annual Access Tariff Investigation Order*, it is the per-line BFP revenue requirement, and not the BFP revenue requirement or line count forecasts individually, that is critical to proper rate development.[39] Because none of the LECs' line count or BFP revenue requirement forecasts was precisely accurate, it would be difficult for the Commission to determine whether a LEC failing our statistical tests exhibited bias in its BFP revenue requirement forecasts, in its line count forecasts, or in some combination of both. Moreover, our primary concern in this investigation has been the accuracy of the LEC's ratemaking, and not the accuracy of individual component forecasts. Even if a LEC were to underestimate its BFP revenue requirement by a substantial amount, its EUCL and CCL charges may nevertheless be correct, and no injury to ratepayers would result, if it were also to underestimate its line count by a similar percentage.[40] Accordingly, we believe that, in developing our prescriptions, we properly prescribed a per-line BFP revenue requirement forecast for use in the LEC's ratemaking.

[38] Bell Atlantic Petition at Exhibit 1.

[39] *1997 Annual Access Tariff Investigation Order* at ¶ 22.

[40] As a simple example, if a price cap LEC forecasts that its BFP revenue requirement will be $40 for the year, and it will have end user demand of 8 lines, its per-line BFP revenue requirement forecast will be $5.00 per line. If its actual BFP revenue requirement for the year turns out to be $50, but it has actual end-user demand of 10 lines, the LEC's per-line BFP revenue requirement forecast, and its resulting EUCL and CCL rates, were precisely correct for the year, despite the underlying errors.

III. Equal Access Exogenous Cost Changes

A. Background

25. In the *Access Reform First Report and Order*,[41] the Commission required LECs to make a downward exogenous adjustment to reflect completion of amortization of equal access expenses. In that Order, the Commission noted that this decision is consistent with previous decisions that ordered exogenous cost decreases to reflect the completion of the amortization of depreciation reserve deficiencies and completion of the amortization of inside wire costs.

26. In the *1997 Annual Access Tariff Investigation Order*, we determined that removal of equal access amortization from LEC rates would be accomplished by an exogenous adjustment to each LECs' PCI, taking into account the growth in revenues that has occurred since 1991. We required this "R" adjustment to ensure that the current price cap would be set at the same level it would have been had the amortization been completed before the initiation of price cap regulation.

27. SBC requests that we reconsider and reverse that portion of the *1997 Annual Access Tariff Investigation Order* which requires the use of an "R" adjustment for the removal of the equal access amortization. SBC asserts that requiring the "R" adjustment is inconsistent with prior Commission orders and that the Commission cannot change its policy without a rulemaking.

B. Discussion

28. As explained in the *1997 Annual Access Tariff Investigation Order*, we had not previously prescribed a specific methodology for price cap LECs to use when adjusting rates in recognition of the completion of a particular amortization.[42] As we observed in that order, the prior decisions dealing with completion of amortization periods did not address the issue of whether LECs should be required to make an "R" adjustment to the PCI to reflect the end of the amortization of these costs.[43] Our decision to do so for the first time in this investigation reflects merely our first consideration on the merits of the issue, not a change in policy.

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[41] *Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982 (1997) (*Access Reform First Report and Order)*.

[42] *1997 Annual Access Tariff Investigation Order* at ¶ 117.

[43] The Commission also did not address whether LECs should make an "R" value adjustment for the removal of payphone costs from the carrier common line deregulation in 1996.

29. We reject SBC's assertion that we cannot distinguish the Common Carrier Bureau's order with regard to the completion of the Other Post Employment Benefits (OPEB) amortization from the removal of the equal access amortization.[44] The Common Carrier Bureau declined to require an "R" value adjustment for the removal of OPEB costs in the 1995 annual access tariff filings because the Commission had not specifically ordered one in the *First Report and Order*.[45] Thus, that decision was another instance in which there was no direct examination of whether an "R" adjustment should be made. It is true that LEC tariffs making downward exogenous adjustments for completion of the inside wire and depreciation reserve deficiency amortizations took effect without an "R" value adjustment. These rates, however, went into effect without an investigation.[46] The fact that some LEC tariffs were allowed to take effect without making an "R" adjustment for completion of amortization costs did not constitute a finding that "R" adjustment should not be required to ensure that LECs remove fully equal access amortization expenses. It is well established that a Commission decision allowing a tariff to go into effect without an investigation "decides nothing concerning the merits of the case; it merely reserves the issues pending a hearing."[47]

30. We also reject SBC's argument that we did not have authority to require an "R" adjustment because this methodology was not adopted pursuant to a rulemaking proceeding. In fact, the Commission has previously determined that a tariff investigation "is a rulemaking of particular applicability" under the Administrative Procedure Act (APA).[48] Moreover, in accordance with the requirements of the APA, we required an "R" adjustment in this investigation after full notice and comment on the methodology that LECs should use to remove equal access exogenous cost expenses. Thus, in the *Designation Order*, the Bureau sought comment on the "R" adjustment and tentatively concluded that a revenue adjustment to the amortized equal access expenses is a reasonable method of fully removing the amortized equal access costs from current rates.[49] In response to the *Designation Order*, SBC and other

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[44] *1995 Annual Access Tariff Filings of Price Cap Carriers*, Memorandum Opinion and Order Suspending Rates, 11 FCC Rcd 5461, 5471 (Com. Car. Bur. 1995) (*1995 Suspension Order*).

[45] *1995 Suspension Order*, 11 FCC Rcd at 5471.

[46] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, 6808 (1991) (*LEC Price Cap Order*).

[47] *Papago Tribal Util. Auth. v. FERC*, 628 F.2d 235, 240 (D.C. Cir. 1980), *cert. denied*, 449 U.S. 1061 (1980).

[48] *Investigation of Special Access Tariffs of Local Exchange Carriers*, Memorandum Opinion and Order, 5 FCC Rcd 4861 (1990), *citing* 5 U.S.C. § 551(4); *Cincinnati Bell Telephone Company Tariff FCC No. 35*, Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 4409, 4413 n.54 (1993).

[49] *Designation Order*, 12 FCC Rcd at 11436.

LECs presented their arguments on the proposed "R" adjustment in their direct cases, other parties addressed this issue in their comments on the direct cases, and LECs provided further comment on this issue in their rebuttals. Accordingly, our decision to require an "R" adjustment was fully consistent with the notice and comment requirements of the APA.

IV. PRTC's Cash Working Capital

A. Background

30. The Commission's rules permit Class A Carriers,[50] such as PRTC, to compute their cash working capital by using either a full lead-lag study or the simplified formula method.[51] Pursuant to Section 65.820(d), once a carrier has selected a method of determining its cash working capital allowance, it shall not change its method from one year to the next year without Commission approval.[52] In its 1997 annual access tariff filing, PRTC elected to calculate its cash working capital by using the simplified formula method to determine its net lag days.

31. In the *1997 Annual Access Tariff Investigation Order*, however, we determined that PRTC's lead-lag study failed to justify its composite net lag of 71.8 days and ordered PRTC to utilize the 15 day standard allowance established by the Bureau for Class B companies.[53] We ordered PRTC to use the 15 day standard allowance because PRTC did not provide adequate support for its assertion that delays in receiving revenues due to the PRTC's dispute resolution process created a substantial overall net revenue lag, thereby increasing its cash working capital needs.[54] We also found that PRTC failed to explain its 143-day expense

[50] Class A carriers are those companies having annual revenues from regulated telecommunications operations that are equal to or above an indexed revenue threshold. 47 C.F.R. § 32.11.

[51] *Amendment of Part 65 of The Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers*, Order on Reconsideration, 4 FCC Rcd 1697, 1698 (1989) (*Rate Base Recon Order*); *see also* 47 C.F.R. § 65.820(e).

[52] 47 C.F.R. § 65.820(d).

[53] *See* 47 C.F.R. § 65.820(d).

[54] PRTC sought an allowance in its calculation of its cash working capital calculations to account for the time involved in waiting to receive revenues that were delayed as result of Puerto Rico's dispute resolution process.

lag for payments in lieu of taxes (PILOT),[55] and that it failed to separate revenues billed in advance from revenues billed in arrears, as required by the Commission's rules.[56]

B. Discussion

32. In its petition, PRTC seeks clarification that, pursuant to Section 65.820(d) of the Commission's rules, it may exercise the option to calculate future cash working capital allowances using the simplified formula method without prior Commission approval. We find that PRTC is not required to obtain prior Commission approval to use the simplified formula method for calculating its cash working capital in future tariff filings. PRTC elected to use the simplified formula when it filed its 1997 annual access tariff. Although we ordered PRTC to use the 15 day standard allowance in the *1997 Annual Access Tariff Investigation Order*, PRTC would not violate Section 65.820(d) of the rules if it elects to use the simplified formula again in future filings because, absent the *1997 Annual Access Tariff Investigation Order*, PRTC would have used the simplified methodology for its 1997 Annual Access Tariff. Accordingly, PRTC's use of the simplified formula method for calculating its cash working capital on a going forward basis is fully consistent with Section 65.820(d) of the Commission's rules.

V. Ordering Clauses

33. Accordingly, IT IS ORDERED, pursuant to sections 1, 2, 4(i), 4(j), 201-205, and 405 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154(i), 154(j), 201-205, and 405, that the petitions for reconsideration filed by the Bell Atlantic Telephone Companies and SBC Communications, Inc., ARE HEREBY DENIED..

33. IT IS FURTHER ORDERED that the petition for reconsideration filed by the Puerto Rico Telephone Company IS HEREBY GRANTED.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas

Magalie Roman Salas
Secretary

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[55] *See 1997 Annual Access Tariff Investigation Order* at ¶ 223. Payment in Lieu of Taxes (PILOT) expense refers to a payment made by PRTC to the government of Puerto Rico.

[56] 47 C.F.R. § 65.830(e)(1)(i)(ii).

SEPARATE STATEMENT OF
COMMISSIONER HAROLD FURCHTGOTT-ROTH

Re: ***1997 Annual Access Tariff Filings, CC Docket 97-149***

While I support today's order denying the petitions filed by Bell Atlantic Telephone Company and SBC Communications, Inc. for reconsideration of our investigation of the local exchange carrier (LEC) 1997 annual access tariff filings, I take the opportunity to express my continued and growing concern with the Commission's micromanagement of LEC's seemingly anachronistic regulatory factors under our price cap rules. As I have previously stated, *see, e.g., Southwestern Bell Telephone Company Tariff FCC No. 73*, 12 FCC Rcd __, __ (released March 13, 1998), I urge the Commission to consider the issue of further pricing flexibility for dominant exchange carriers in the context of the Commission's pending Access Charge Reform proceeding. The amount of detailed information required under our current price cap rules by these tariffs is inordinate and should be reduced, possibly in the context of providing further pricing flexibility for dominant LECs in general. I continue to await anxiously the opportunity to address more fully these issues and the circumstances under which dominant LECs should be accorded a simpler form of price cap regulation.

In addition, I am becoming increasingly convinced that many of the current regulatory mechanisms are no longer necessary in today's increasingly competitive environment. We must develop a more forward-looking blueprint to guide the transition from price cap regulation to even more flexible, streamlined regulation as competition begins to take hold in a particular geographic or service market. As I have stated previously, price cap regulation is merely designed, to the extent possible, to replicate a competitive marketplace, but any form of regulation is an imperfect surrogate for full-fledged competition. At a minimum, we should implement a system of pure price cap regulation for the largest carriers, under which there would be little need for the level of detailed information currently required in the annual tariff filings.

I believe we should at least consider even further deregulation so that such cumbersome regulations are unnecessary. I encourage all interested parties to urge the Commission to use this year's first biennial review to revise its rules and regulations regarding tariff filings and uniform system of accounts to eliminate as many of these regulations as possible.